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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates	)	CC Docket No. 93-251

COMMENTS OF THE BELL ATLANTIC TELEPHONE COMPANIES

I. Introduction and Summary.

At a time when competition in the telecommunications industry is moving forward more rapidly than almost anyone anticipated, the rules proposed in this proceeding[1] would take a substantial, and ill-advised, step backward. The Bell Atlantic telephone companies[2] respectfully oppose those rules, and urge the Commission not to adopt them.

The proposed rules are fundamentally inconsistent with the Commission's many policy initiatives to promote efficiency, foster competition and reduce regulatory burdens. The Commission and state commissions all over the country have recognized they must move away from traditional rate base, rate-of-return regulation. This Commission has adopted price cap regulation, and many states have adopted other forms of incentive regulation. This proposal, however, merely refines and expands rules that were

[1] *Notice of Proposed Rulemaking*, FCC 93-453 (rel. Oct. 20, 1993) ("NPRM").

[2] The Bell Atlantic telephone companies ("Bell Atlantic") are The Bell Telephone Company of Pennsylvania, the four Chesapeake and Potomac telephone companies, The Diamond State Telephone Company and New Jersey Bell Telephone Company.

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developed for traditional, obsolete, rate of return regulation.[3]

In addition, the proposed rule refinements are unnecessary, unduly complex, and will be costly and burdensome to administer for both carriers and their affiliates. Most important, the proposed rules will not benefit ratepayers, but will instead discourage efficiencies and impose a substantial competitive disadvantage on carriers.

The Commission's affiliate transaction rules currently distinguish between the transfer of assets and the provision of services. The proposed rules would not only eliminate that distinction and make both kinds of affiliate transactions subject to the more stringent asset transfer rules, but it would also add considerable complexity to the process. For example, in determining how to record the cost of many services, carriers would first have to estimate the fair market value of the service and compare that value to the fully distributed costs of providing that service. They would then record the cost at the higher of fully distributed costs or estimated fair market value when a carrier is the seller, and at the lower of fully distributed costs or estimated fair market value when a carrier is the purchaser.

Similarly, the NPRM contains forty-one paragraphs of detailed proposed instructions as to how nonregulated affiliates must calculate their costs. NPRM at ¶¶ 40-81. The effect would be

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[3] "In adopting the affiliate transactions rules, the Commission was attempting to develop a workable system of compensating for the faulty incentives traditional rate of return regulation gives carriers in relation to affiliate transactions." NPRM at ¶ 8 (emphasis added).

to apply to nonregulated affiliates all of the Commission's rules applicable to carriers, including those relating to rate base methodology, an allowable rate of return, and an allowable expense methodology. Id. at ¶¶ 57-76. They would also have to develop "procedures for estimating affiliate transactions costs, monitoring the estimates' accuracy, and truing-up if necessary." Id. at ¶ 77. These proposals not only increase the regulatory burden on the carriers, they replicate much of that burden for affiliates that are offering nonregulated products and services. There is no justification for such heavy-handed re-regulation.

II. The Proposed Rules Are Inconsistent With The Commission's Pro-Competitive, Deregulatory Policies.

The proposed re-regulatory rules are inconsistent with the recent trend, fostered by the Commission and many states, to move away from rate of return regulation. Price caps, and other progressive forms of incentive regulation at the federal and state levels, have supplanted many of the relics of traditional rate of return regulation. In a competitive environment, these new forms of regulation are the least that are needed to allow local exchange carriers ("LECs") to compete with the growing array of well-financed, strong competitors. With effective marketplace competition becoming commonplace, old-style intensive rate regulation is not only unnecessary, it is counter-productive.

The Commission's proposal, however, drives in the very opposite direction. Not only are the new rules entirely unnecessary, but they will further increase the LECs' difficulty in participating effectively in the competitive marketplace. They add undue complexity, cost inefficiencies, and burdens on the LECs, while leaving their competitors free of regulatory constraints and burdens.[4] Most important, there is no demonstrable need for these changes -- the Commission does not cite one shred of evidence that the current rules are insufficient or ineffective.

A. The Proposed Rules Are Out Of Step With Today's Telecommunications Environment.

One of the primary virtues of price cap regulation is that it eliminates incentives to cross-subsidize while creating incentives to reduce costs and increase efficiency. As the Commission has recognized, under price cap regulation "a carrier's primary means of increasing earnings are to enhance its efficiency and innovate in the provision of service. Because cost padding and cross-subsidization do not justify higher prices under this system -- but instead lower profits -- the incentives to engage in such activity are limited."[5] In moving away from rate of return regulation, therefore, the Commission has alleviated many of its earlier reasons to scrutinize the details of affiliate transactions. Carriers have no incentive to subsidize their

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[4] These competitors include large, multi-faceted companies that could easily cross-subsidize their telecommunications operations.

[5] *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) at ¶ 36.

nonregulated affiliates because they cannot recover the subsidy from ratepayers.

Competitive pressures also prevent carriers from attempting to subsidize their affiliates. Largely as a result of the Commission's pro-competitive policies, LECs face competition in all aspects of their business, including toll, special and switched access, directory, and local service. This competition comes from competitive access providers, cable television companies, interexchange carriers, wireless service providers, and a host of other well-funded, aggressive companies. These companies are generally subject to very streamlined federal and state regulation -- they have no "carrier of last resort" obligations, they have almost infinite pricing flexibility, and they need not incur huge costs in meeting detailed regulatory obligations.

In the face of this competition, local exchange carriers know they must reduce their costs and become more efficient. They have no incentive to increase their costs by attempting to subsidize their affiliates.

The NPRM simply ignores these realities. Instead, it assumes that affiliate transactions will, by themselves, override all these considerations and motivate carriers to operate inefficiently. NPRM at ¶ 32. This assumption is fundamentally at odds with today's telecommunications marketplace.

The Commission's primary concerns in proposing the rule changes are that:

> By requiring carriers to record services they sell to nonregulated affiliates at the carriers' fully

> distributed costs even when those costs are less than what non-affiliates would pay the carriers, the rules motivate carriers to sell services for less than fair market value. Similarly, by permitting carriers to record services purchased from nonregulated affiliates at the affiliates' fully distributed costs even when those costs exceed what the carriers would pay non-affiliates, the rules motivate carriers to pay more than fair market value for services. NPRM at ¶ 32.

Neither of these concerns is valid.

The Commission's first point fails to address what happens when a carrier charges an affiliate the fully distributed costs of providing a service. As an economic matter, using fully distributed costs ensures that there can be no cross-subsidy. There is, therefore, no harm to the ratepayer. As a practical matter, ratepayers will benefit because the affiliate will have paid a share of the common overheads which the ratepayers would have borne had the transaction not taken place.

The Commission's second claim is inconsistent with the existence of price caps and competition. Just because a LEC records a transaction on its books at fully distributed costs, that does not mean that the costs will be recovered from ratepayers as they would under rate of return regulation.[6] Accordingly, a carrier subject to incentive regulation and facing competition has no incentive to pay more than the fair market value for a service simply because it is provided by an affiliate. Instead, the many incentives to reduce costs will cause the carrier to buy elsewhere if its costs, actual or artificially imputed, can be reduced.

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[6] An affiliate transaction would not be given exogenous treatment and, therefore, would have no effect on the Price Cap Index.

The Commission appears to acknowledge that price caps obviate the need for affiliate transaction rules by suggesting that the proposed rules should not apply to AT&T. NPRM at ¶ 101. It claims, however, that the LECs are different because it has imposed "extensive sharing obligations" on the LECs, and not on AT&T. Id. at ¶ 103. At the same time, the NPRM acknowledges that the Commission will soon be conducting a "price cap LEC performance review," and may decide to alter the sharing mechanism. Id. In these circumstances, the best course of action is to remove the disincentives in price cap regulation, not increase the disincentives in the affiliate transaction rules. At the very least, it would be prudent for the Commission to defer considering new LEC affiliate transaction rules until after its price cap review.

B. The Proposed Rules Will Impose Unreasonable Burdens, With No Demonstrated Public Benefits.

There is no question that the proposed rules are significantly more complex than the current rules. While carriers must still calculate the fully distributed cost of services, they would also be required to determine the estimated fair market value of those services. Given the number of specific services involved, and the fact that some of the services which carriers obtain from affiliates are not readily available in the marketplace, that additional task would be significant, and costly.[7] Moreover, nonregulated affiliates would have to develop elaborate regulatory procedures to ensure that their cost calculations comply with the Commission's myriad detailed rules governing the development of rate base, allowable expenses, and rate of return.[8] All of these additional burdens will be magnified because the proposed rules would restrict the use of prevailing company prices, and therefore increase the requirements to calculate both cost **and** fair market value.[9] NPRM at ¶ 24, n.19.

Bell Atlantic's affiliate transactions are generally designed to obtain the benefits of centralization and economies of scale and scope. Bell Atlantic Network Services, Inc., for example, performs work for all seven telephone companies when it is

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[7] In its comments, USTA will provide industry estimates of the costs of this task. Beyond such estimates, however, carriers cannot reasonably be expected to quantify the potential impact of the proposed rules, as the Commission requests. NPRM at ¶ 109. The complexity of the proposed rules, and the burdens they impose, might so discourage affiliate transactions that carriers would have to find new ways to conduct business. Only experience will give an accurate quantification of the costs and inefficiencies caused by the new rules.

[8] There can be no assurance, moreover, that procedures designed for regulating telephone companies can reasonably be applied to the operations of some nonregulated affiliates. For example, some nonregulated affiliates are labor-intensive, with little capital investment. The reasonableness of their prices, therefore, cannot be judged by the return they earn on investment.

[9] The Commission claims that reliance on prevailing company prices "may unnecessarily burden both this Commission and carriers." NPRM at ¶ 15. The alternative in the proposed rules, however, to determine both fully distributed costs <u>and</u> estimated fair market value for services, would be far more burdensome.

more efficient to do the work once instead of seven times. This centralization clearly benefits ratepayers by making the companies more efficient and productive, and the Commission should not adopt rules which will discourage these kinds of affiliate transactions, and thus harm ratepayers.[10]

The Commission even acknowledges that it expects the proposed rules to be burdensome (NPRM at ¶ 43), and that they will discourage affiliate transactions. NPRM at ¶ 24, n.19 & ¶ 29. Nowhere, however, does the Commission attempt to justify how its proposal will serve the public interest. Although the Commission asserts its proposal is based on an analysis of the current rules after six years of experience, it provides not a single example of a transaction over those six years which harmed the public. Instead, the entire discussion is a theoretical one about **potential** transactions which **might** harm the ratepayer. If the current rules have produced no problems, and the proposal is justified by experience under those rules, there is no reason to change them.

Finally, the LECs' competitors will not be subject to such a burdensome set of rules. If the Commission adopts the proposed rules, therefore, it would be thwarting the competition it

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[10] In approving the current rules, the D.C. Circuit Court of Appeals acknowledged that the asymmetrical asset transfer rule could "prevent certain transactions favorable to ratepayers." Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1381 (D.C. Cir. 1990). It relied, however, upon the Commission's representation that the rule would apply only "'in a limited number of cases' since a prevailing price will exist in most instances." Id. If the Commission expands that asymmetrical rule to apply to services as well, and greatly limits the use of prevailing prices in both instances, as proposed, there can be no assurance that the rule will pass legal muster.

is trying to foster. Indeed, the IXCs, one of the LECs' major competitors, would be the primary beneficiary of the proposed rules. That is because the rules would only operate to disallow regulated costs, and thus increase the chances the LECs would have to "share" revenues. Their sharing obligations, however, would accrue to the benefit of the IXCs, not the end user ratepayers, and the IXCs have not passed on all the access charge reductions they have received. The result would therefore be a double win for them. It would increase their profits and hobble their competitors with unreasonable regulatory burdens. That result is clearly not in the public interest.

III. **Conclusion**

The rules proposed in this proceeding are unduly complex and would impose unreasonable burdens and costs on the telecommunications industry. They are also unnecessary and would provide no benefits to anyone but competitors of the local exchange carriers. They should therefore not be adopted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing "Comments of the Bell Atlantic Telephone Companies" was served this 10th day of December, 1993, by first class mail, postage prepaid, on the parties on the attached list.

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